BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
GEORGE AND RUBY YOUNG )

Appearances:

For Appellants: John Shepard and Dwight A. Carlson, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel; F. Edward Caine, Senior Counsel

## O P I N I O N

These appeals are made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of George and Ruby Young to proposed assessments of additional personal income tax in the amount of $5,649.02 assessed against each appellant for the year 1951 and In the amounts of $12,439.91, $11,350.29, $11,772.41 and $10,376.99 assessed against appellants jointly for the years 1952, 1953, 1954 and 1955, respectively.

Appellant George Young (hereinafter called appellant) conducted a coin machine business centered in Selma, California. Appellant owned music machines, bingo pinball machines, shuffle alleys and some miscellaneous amusement machines. The equipment was placed in various locations such as bars and restaurants.

The proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between appellant and the location owner.

The gross income reported in tax returns was the total of amounts retained from locations. Deductions were taken for depreciation and other business expenses. Respondent determined

that appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him. Respondent also disallowed all expenses pursuant to section 17297 (17359 prior to June 6, 1955) of the Revenue and Taxation Code, which reads:

> In computing taxable income, no deductions shall be allowed to any taxpayer on any of his gross Income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code or' California; nor shall any deductions bc allowed to any taxpayer on any of *his gross* Income derived *from* any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

Appellants urge that section 17237 is unconstitutional. Some of the constitutional objections raised by appellants with respect to this section were disposed of in Hetzel v. Franchise Tax Board, 161 Cal. App. 2d 224 [326 P.2d 611]. In any event, wc adhere to our well established policy not to pass upon the constitutionality of a statute in an appeal involving unpaid assessments, since a finding of unconstitutionality could not be reviewed by the courts. (Appeal of c. B. Hall, Sr., Cal.St. Bd.of Equal., Dec. 29, 1958.)

The evidence indicates that the operating arrangements between appellant and each location owner were the same as those considered by us in the Hall appeal, supra. Our conclusion in Hall that the machine owner and each location owner were engaged in a joint; venture in the operation of these machines is, accordingly, applicable here. Thus, only one-half of the amounts deposited in the machines operated under these arrangements was includible in appellant's gross income.

In Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., Oct. 9, 1962, we held theownership or possession of a pinball machine to be illegal under Penal Code sections 330b, 330.1 and 330.5 if the machine was predominantly a game of' chance or if cash was paid to players for unplayed free games, and we also held bingo pinball machines Lo be predominantly games of chance.

At the hearing of this matter, three location owners denied making payouts for free games and two gave uncertain answers. However, one of those witnesses testified that in some instances the expenses were greater than the proceeds from the machine, an occurrence which is unlikely in the absence of

cash payouts for free games; another had been convicted of making payouts on pinball machine3 during the years under appeal; and another admitted making payouts prior to the years under appeal and was not sure when the payouts ceased. On the other hand, one location owner forthrightly admitted regularly making payouts for free games.

Appellant declined to answer all questions concerning his coin machine business on the ground of possible self-incrimination. By filing this appeal and then claiming the privilege against self-incrimination, appellant has placed himself in the untenable position of seeking relief from this board while failing to support his contentions or to lend any assistance to this board In determining the merits of the appeal. In addition, it has been held that a party's refusal to answer a question on the ground of possible self-incrimination can give rise to an inference that a truthful answer to the question would have supported the opposing party's factual contentions. (Fross v. Wotton, 3 Cal. 2d 834 [44 P.2d 3501.)

Based on the Inferences to be drawn from appellant's refusal to answer questions relating to the operation of the bingo pinball machines on the ground of possible self-incrimination and on the evidence of cash payouts before us, we find that It was the general practice to pay cash to player3 of the bingo pinball machines for unplayed free games. Accordingly, the bingo pinball phase of appellant's coin machine business was Illegal both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players. Respondent was therefore correct In applying section 17297.

Several of the locations had both pinball machines and music machines. Appellant and his employee collected from and serviced all type3 of machines. Appellant's coin machine business was highly Integrated and we find that there was a substantial connection between the Illegal activity of operating bingo pinball machines and the legal activity of operating music machines and miscellaneous amusement machines. Respondent was therefore correct in disallowing the expense3 of the entire business.

There were not complete records of amount3 paid to winning player3 on the bingo pinball machines and respondent estimated these unrecorded amount3 as equal to 45 percent of the total amount deposited In such machines. Respondent's auditor testified that the 45 percent payout figure was based on estimates given to him by location owners during Interviews at the time of the audit and on Investigations of other pinball operations in Fresno and Kings Counties. The only other evidence on this point is an estlmate made by one location

owner at the hearing of this matter that payouts on bingo pinball machines averaged about 50 percent of the amounts deposited in the machines.

As we held in the Hall appeal, supra, respondent's computation of gross Income is presumptively correct. Appellants have not overcome this presumption, and since respondent's estimate seems reasonable, we sustain the 45 percent estimate.

In connection with the computation of the unrecorded payouts, it was necessary for respondent's auditor to estimate the percentage of appellants' recorded gross income arising from bingo pinball machines. Respondent 's auditor estimated that the receipts from the bingo pinball machines constituted 35 percent of the total receipts for the period from May 3, 1951, through December 31, 1951, 35 percent in 1952, 40 percent in 1953, 50 percent in 1954, and 45 percent in 1955. In the absence of other information In this regard, we can see no reason to disturb this allocation.

Finally, appellants question the timeliness of the proposed deficiency aascssmcnt levied against each appellant on June 6, 1957, relative to the year 1951. Appellants each filed a return for the latter year on April 15, 1952. On December 12, 1955, in accordance with section 18589 of the Revenue and Taxation Code, appellants filed waivers of the statute of limitations which provided that respondent might issue deficiency assessments relative to the year 1951 any time on or before April 15, 1957. On January 14, 1957, additional waivers were filed by appellants which extended the statute of limitations for proposing deficiency assessments to April 15, 1958. Accordingly, proposed deficiency assessments Issued on June 6, 1957, for the year 1951 were timely.

## ORDER

Pursuant to the views expressed in the opinion of the board on file In this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of George and Ruby Young to proposed assessments of additional personal income tax in the amount of $5,649.02 assessed against each appellant for the year 1951 and in the amounts of $12,439.91, $11,350.29, $11,772.41 and $10,376.99 assessed against appellants jointly for the years 1952, 1953, 1954 and 1955, respectively, be modified in that the gross income is to be recomputed in accordance with the opinion of the board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Pasadena, California, this 20th day of April, 1964, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

Attest: _____, Secretary